

**Copyright – Reproduction v. Usage – Much Awaited Judgment of Decade - Engineering Analysis  
Centre of Excellence Private Limited**

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This article is on one of the vexatious issues of taxation on the software payments made by residents to non-residents. The said issue was put to an end by the Honourable Supreme Court in the matter of Engineering Analysis Centre of Excellence Private Limited<sup>1</sup> (for brevity 'EAC') in favour of the tax payer. Let us proceed to understand the core issues, the history involved surrounding the issue, the arguments by and against tax payer, the analysis by Supreme Court and conclusions therein.

**Issue:**

The issue predominantly revolves around whether the payments made by resident towards various usages of software to non-residents requires withholding obligations under Section 195 of Income Tax Act, 1961 (for brevity 'ITA').

The tax payer's principle assertion (through the payer) is that since the payments were made for usage of software, the same would not fall under the definition of 'royalty' as provided in Explanation 2 to Section 9(1)(vi) of ITA. Further, assuming that the amendment made to Section 9(1)(vi) by inserting Explanation 4 in 2012 with retrospective effect from 1976, to make it clear that granting of license is also included in all or any of the rights involved in a copyright, the tax payer argument was that since the said amendment was not on statute book as on the date of payments to non-resident vendors, the provision cannot be applied to the matters in hand. Apart from the above, the tax payer also argued that he would be covered under the protection of Double Taxation Avoidance Arrangement (for brevity 'DTAA') and thereby there is no income which accrues or arises or deemed to accrue or deemed to arise in India and accordingly the payer is not required to deduct any tax under Section 195 on the payments made. The tax payer argued that what was transferred to end-user was a non-exclusive restricted license to use the software. In other words, a copyrighted article is being sold and not the copyright. The payments which are mentioned either under Section 9(1)(vi) or Article 12 of DTAA are those which cover the payments for transfer of copyrights and not deal with copyrighted article.

The Revenue's principle assertion is that the grant of license of a computer programme, being specifically included in Explanation 4 to Section 9(1)(vi) makes the legislative intent clear to treat such payments to fall under the ambit of 'royalty'. Since the ITA deals with the definition of 'royalty', there is no requirement to look for the meaning under Copyright Act, 1957 (for brevity 'Copyright Act'). Further, all the DTAA's define the 'royalty' to mean payment of consideration for use or right to use the copyright. Since the subject payments are for use or right to use the computer software, the said payments are obviously covered under the DTAA and accordingly the payer is required to withhold tax on the same. Further, the Revenue also stated that the retrospective amendment made qua Explanation 4 is only for removal of the doubts and has to be interpreted not as a new thing. The Revenue argued that derivative product of copyright is also covered under the ambit of Section 9(1)(vi) and thereby payment made for usage of software would mean to accrue or arise or deemed to accrue or deemed to arise in India for the non-resident vendors. The revenue also stated that in certain facts of the appeals, the agreement involved is the distribution agreement with the non-resident, by virtue

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<sup>1</sup> [2021] 432 ITR 471 (SC)

of entering the distribution agreement the non-resident parted with the rights mentioned in Section 14(b)(ii) of Copyright Act and accordingly the payment would fall under the ambit of 'royalty', since the said payment was a consideration for transfer of all or any of the rights mentioned in Section 14.

With the above in place, let us proceed to examine, the history of the issue and the other aspects connected.

**History:**

The facts in the matter of EAC, a resident Indian company has purchased an end-user shrink wrapped computer software, directly imported from United States of America (for brevity 'USA'). The payment was made for the shrink wrapped computer software without any deduction of tax at source. The tax authorities opined that the said payment for shrink wrapped computer software involves payment for copyright which attracted the payment of royalty under both Article 12(3) of Indo-USA DTAA and Section 9(1)(vi) of ITA. The EAC pleaded that the subject payment is only for usage of the software but does not involve any payment for the copyright and cannot be categorised as royalty, which would required withholding of tax. The Assessing Officer was not convinced with the submissions has upheld the order confirming the withholding of tax. The matter when taken to Commissioner (Appeals) was held against EAC. However, EAC succeeded before the Tribunal. The Tribunal following its earlier judgment in Samsung Electronics Co. Limited has dismissed the order of Commissioner (Appeals) and held that there was no obligation on the EAC to withhold any tax. Aggrieved by this, the Revenue has preferred an appeal to High Court of Karnataka. The High Court of Karnataka hearing the matter of EAC along with other clubbed appeals, framed nine questions of which, two of them deal with issue of copyright.

The High Court after framing of the questions, without venturing into the merits, has concluded that the payments made by end-users for purchase of software requires deduction of tax at source. The High Court has passed the above judgment vide its order dated 24.09.2009. The High Court has majorly placed reliance on the decision of Supreme Court in the matter of Transmission Corporation of AP Limited<sup>2</sup> for arriving the said conclusion. The High Court accepted the submissions by revenue that unless the payer makes an application under Section 195(2) and has obtained a permission for non-deduction of tax, it was not permissible for the payer to contend that the payment made to non-resident did not give rise to income taxable in India.

The above judgment of High Court of Karnataka was appealed before the Honourable Supreme Court in a batch of appeals. The Supreme Court after detailing the facts and analysing the judgment of Transmission Corporation of AP Limited (supra) stated that the High Court of Karnataka has misunderstood the ratio in the matter of Transmission Corporation of AP Limited (supra) and thereby misapplied the same in the matter of Samsung Electrical Co. Limited<sup>3</sup> (supra) and reiterated that every payment made to non-resident would not require deduction of tax at source and only such payments which are chargeable to tax in India would only fall under the ambit of the withholding obligation. This became a landmark judgment by Supreme Court in the matter of GE Technology Centre Private

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<sup>2</sup> [1999] 007 SCC 266

<sup>3</sup> This was a batch of appeals involving EAC matter also. The judgment was delivered in the name of lead party, which is Samsung Electrical Co. Limited.

Limited<sup>45</sup>. The said judgment reversed the decision of High Court of Karnataka in the matter of Samsung Electrical Co. Limited and asked the High Court to consider the matter at fresh.

When the matter came for the second time before the High Court of Karnataka, vide its judgment dated 15.10.11 in the matter of Samsung Electrical Co. Limited<sup>6</sup> held that, what was sold by way of a computer software included a right or interest in copyright, which thus gave rise to payment of royalty and would be an income deemed to accrue in India in terms of Section 9(1)(vi) and accordingly obligating the payer to deduct tax. This was challenged before Supreme Court, where the Court has taken EAC as the lead matter for analysing the facts involved and to arrive at a conclusion.

**Arguments:**

As discussed earlier, the current matter involves a large number of petitions which involve determination of taxation on various usages of software. Based on the facts involved, the apex court has basketed them into four broad categories, which are as under:

<b>Category</b>	<b>Description</b>
<b>I</b>	Computer Software purchased directly by a resident end-user
<b>II</b>	Computer Software purchased by resident Indian distributors/resellers
<b>III</b>	NR <sup>7</sup> Distributors reselling Computer Software to Indian Distributors or end-users
<b>IV</b>	Computer Software is affixed onto Hardware and sold as a unit to resident end-user

**Arguments by Tax Payers:**

The facts are that the resident Indian Companies are non-exclusive distributors of computer software. They purchase off-the shelf copies of shrink wrapped software from foreign companies for onward sale to Indian end-users under a remarketer agreement.

**On Taxation:**

The tax payer has asserted that the Indian distributor is not a party to the End User License Agreement (for brevity 'EULA') between the end-user and the foreign supplier. The tax payer's argument was that they simply do not own any right, title or interest in copyright or other intellectual property owned by the foreign supplier and they just market the foreign supplier's software. The end-user pays to the Indian distributors and after retaining certain part as profit, the Indian distributors pays to the foreign supplier. Hence, the amounts paid by the Indian distributor does not partake the character of royalty since the payment is not made for any rights involved. The tax payer also stated that the computer software imported for onward sale constitutes as 'goods' in light of the Supreme Court judgment in Tata Consultancy Services<sup>8</sup>. The tax payer also making reference to DTAA's in place, stated that the DTAA's do not cover the derivatives products of royalties and cover only the core right and assuming that Section 9(1)(vi) covers the current payment as royalty, in terms of Section 90(2), the beneficial provisions of DTAA has to be invoked and accordingly there is no income which would accrue to the foreign supplier in India and accordingly the Indian distributor is not obligated to withhold the tax.

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<sup>4</sup> [2010] 327 ITR 456 (SC)

<sup>5</sup> This was a batch of appeals involving Samsung Electrical Co. Limited matter also. The judgment was delivered in the name of lead party, which is GE Technology Centre Private Limited.

<sup>6</sup> [2012] 345 ITR 494

<sup>7</sup> Non-Resident

<sup>8</sup> [2005] 1 SCC 308

The tax payer has also submitted that the Explanation 4 inserted to Section 9(1)(vi) vide Finance Act, 2012 giving retrospective effect from 1976 also can cover only 'any right, property or information used or services utilised' but cannot be read to expand the definition of 'royalty' as contained in Explanation 2 to Section 9(1)(vi). The tax payer has also challenged that the Explanation 4 cannot be pressed into service since it would compel them to do an impossible task, since at the time of making the payment, the said explanation was not in vogue. Hence, on a retrospect, the revenue cannot ask the payer to withhold taxes.

**On Copyright Act:**

The tax payer further making reference to the Copyright Act, 1957 (for brevity 'Copyright Act') asserted that there is a difference between copyright in an original work and copyrighted article. Under the remarketer agreement, no copyright would be given by the foreign supplier to the Indian distributor or the end-user. The end-user is only entitled only a limited license to use the product by itself, with no right to sub-license, lease, make copies. Hence, the said limited right parted by foreign supplier would not fall under the ambit of 'royalty' as envisaged in DTAA's.

The tax payer has stated that the amendment to Section 14(b)(ii) of Copyright Act with effect from 2000 by removing the words 'regardless of whether such copy has been sold or given on hire on earlier occasions' is a statutory application of the doctrine of first sale/principle of exhaustion. The amendment made it clear that since no distribution right by the original owner extended beyond the first sale of the copyrighted goods, it can be said that only the goods has been passed to the imported and not the copyrights in the goods.

**Arguments by Revenue:**

**On Taxation:**

The Revenue's principal argument was that the introduction of Explanation 4 to Section 9(1)(vi) is only a clarificatory in nature and accordingly the payer was obliged to deduct taxes even such explanation was not on statue book as on the date of payment. The Revenue stressed that importance has to be given to phrase 'in respect of' appearing in Explanation 2(v) of Section 9(1)(vi) to bring home the point that derivate products of copyright are also covered under the ambit of 'royalty'. The Revenue placed reliance on decision on PILCOM<sup>9</sup>, wherein it was held that irrespective of the fact that the payment was chargeable to tax in India, the payer has to withhold tax. The PILCOM judgment was in the context of Section 194E.

**On Copyright Act:**

The Revenue stated that since in some of the cases, adaptation of software could be made, albeit for installation and use on a particular computer, the same would be possible only if the original owner has parted with his copyrights and asked to consider that such payments would be falling under the ambit of 'royalty'. The Revenue also stated that in terms of Section 52(1)(ad) of Copyright Act, that only making copies or adaptation of a computer programme from a legally obtained copy for non-commercial, personal use would not amount to infringement, and in cases where the same are copied for commercial purpose would constitute infringement and in certain cases, the same were being copied for commercial purposes would result in infringement, thereby meaning that the original owner has parted the rights therein. In light of the above, the Revenue stated that the payments were

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<sup>9</sup> 2020 SCC Online SC 426

for royalties and accordingly the payer would have to withheld taxes at source and failing to do so, the tax payers has not met the obligations.

**Analysis by Supreme Court:**

The Supreme Court after setting out the provisions of ITA and Copyright Act has brushed away the argument of Revenue which canvassed the view that the payer has to withhold tax at source even such income is not chargeable to tax in India. The Court stated that Section 195 is clear to state that the obligation of withholding would trigger only if such income was chargeable to tax in India, which is again determined by applying the provisions of Section 5 read with Section 9. The Court reiterated that the above position is made abundantly clear in the matter of GE Technology Centre Private Limited (supra). The Court also brushed the reliance of Revenue in the matter of PILCOM (supra) stating that, the said judgment was in the context of Section 194E and not under Section 195. The Court stated that the provisions of Section 194E does not have any reference to chargeability of income under the provisions of ITA, which do find a place in Section 195. Hence, the decision in PILCOM which was dealing on obligation of withholding of tax for payments made under Section 194E, which do not have reference to any chargeable to tax in India cannot be applied to situation under Section 195.

The Court stated that though the phrase 'copyright' has not been defined in the Copyright Act separately, the provisions of Section 14 of the said act makes it clear that 'copyright' to mean the 'exclusive right' subject to provisions of the act, to do or authorise the doing of certain acts 'in respect of a work'. Thus, when an author in relation to 'literary work' which includes a 'computer programme', creates such work, such author has an exclusive right, subject to the provision of the Act, to do or authorise the doing of several acts in respect of such work. When the owner of copyright in a literary work assigns wholly or in part, all of any rights contained in Section 14(a) and (b), in the said work for a consideration, the assignee of such right becomes entitled to all such rights comprised in the copyright that is assigned, and shall be treated as owner of copyright of what is assigned to him. Further, the owner of copyright in any literary work may grant any interest in any right mentioned in Section 14(a) by license in writing by him to the licensee, under which, for parting with such interest, royalty becomes payable. When such license is granted, copyright is infringed when any use, relating to the said right/interest that is licensed, is contrary to the conditions of the license so granted. Hence, if the right parted by the original owner/author is to allow another person to reproduce and commercially exploit the intellectual property involved, then the person would not be said to be infringing the copyright since he has not violated any conditions of the license. Accordingly, the Court brushed away the plea of Revenue, wherein it was asserted that making copies of copyright and using them would mean infringement of copyright.

**Reproduction vs Usage:**

The Court then referring to the conditions in various contracts has stated that what is granted to the distributors is only a non-exclusive, non-transferable license to resell computer software and it is expressly stated that no copyright in the computer programme is transferred either to the distributor or to the end-user. The Court stated that the distributor retains only part of the consideration as profit and the retention is also for the reason that the distributor is a reseller but not because he has obtained a right to use the product. Further, the end-user who is directly sold the computer programme, can use only it by installing it in the computer hardware owned by the end-user and cannot in any manner reproduce the same for sale or transfer, contrary to the term of EULA. The Court stated that none of the facts involved in the current appeals involves grant of license in terms of Section 30 of Copyright Act, which transfers an interest in all or any of the rights contained in Section

14(a) and 14(b). The Court stated that only such grant of licenses which fall under the category of Section 30 can be said to be grant of copyright in order to characterise the income arising thereof as a royalty. Since all the EULAs impose restrictions or conditions for use of computer software, it cannot be said what was granted was a license in terms of Section 30. The Court took an example to elucidate the said point. If an English publisher sells 2000 copies of a particular book to an Indian distributor, who then resells the same at a profit, no copyright in the aforesaid book is transferred to the Indian distributor, either by way of license or otherwise, in as much as the Indian distributor only makes a profit on the sale of each book. Importantly, there is no right in the Indian distributor to reproduce the aforesaid book and then sell the copies of the same. On the other hand, if an English publisher were to sell the same book to an Indian publisher, this time with the right to reproduce and make copies of the aforesaid book with permission of the author, it can be said that copyright in the book has been transferred by way of license or otherwise, and what the Indian publisher will pay for, is for the right to reproduce the book, which can then be characterised as royalty for the exclusive right to reproduce the book in the territory mentioned by the license.

The Court then proceeded to make a reference to the judgment of State Bank of India<sup>10</sup> which was under the Customs Act, 1962 (for brevity 'Custom Laws'). The issue involved therein is State Bank of India has imported a consignment of computer software and manual from Kindle Software Limited, Ireland and cleared the goods for home consumption on payment of customs duty. State Bank of India has filed a refund application stating that interpretative note relating to Rule 9(1)(c) of Customs Valuation (Determination of Price of Imported Goods) Rules, 1998 suggests that royalties and licenses paid for right to reproduce the imported goods should not be added to the price actually paid or payable. State Bank of India has taken a plea that since the software imported involves right to reproduce, the royalties paid should not be added to the assessable value of the goods. Since the same were already included, State Bank of India has applied for refund. The Court in the said matter made an important observation vide Para 21. It stated that reproduction and use are two different things. Since in the facts of State Bank of India, what was permitted by Kindle Software Limited is use but not the right to reproduce. The Court stated that what was paid by State Bank of India was for the license and not the right to reproduce and accordingly State Bank of India would not be eligible for refund. Taking clue from the above judgment, the Supreme Court in the matter of EAC stated that the right to reproduce would entail parting of copyright and whereas right to use does not entail any copyright.

The Court also referring to the real nature of transactions involved stated that what is licensed by foreign, non-resident supplier to the distributor and resold to the resident end-user, or directly supplied to end-user, is in fact the sale of a physical object which contains an embedded computer programme and therefore, essentially a sale of goods as held by the Supreme Court in the matter of Tata Consultancy Services (supra).

The Supreme Court then proceeded to analyse the definition of 'royalty' in the context of DTAA and ITA. The Court analysed that the definition under Article 12(3) of Indo-Singapore DTAA which deals with 'royalty' is exhaustive and differs with the definition under the local law at least in three aspects. The main aspect under the provision of ITA is the presence of Explanation 2(v) to Section 9(1)(vi). Vide such part of the explanation, 'the transfer of all or any rights (including the granting of license) in respect of copyright, literary, artistic or scientific work including..' is covered under the definition of 'royalty'. Harping on this, the Revenue contested that the consideration received by foreign supplier for granting of license comes under the ambit of 'royalty' because it specifically gets mentioned in Explanation 2(v).

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<sup>10</sup> [2001] 1 SCC 727

However, the Supreme Court rejected the above contention by stating that a payment to fall under the ambit of Explanation 2(v) should in the first place involve transfer of all or any rights. The rights that are being discussed are the rights that were mentioned in Section 14(a), Section 14(b) and Section 30 of Copyright Act. Hence, unless the rights which are mentioned in Section 14(a) and Section 14(b) are transferred either in full or any, there is nothing which falls under the ambit of Explanation 2(v). The phrase ‘including the granting of license’ has also to be read to mean that the grant of license includes the parting of rights as mentioned in Section 14(a) and Section 14(b). Since in all the matters, the facts involved the granting of license which is not in the nature of Section 14(a) and Section 14(b), such consideration arising for grant shall not fall under the ambit of Explanation 2(v) to Section 9(1)(vi).

**Conclusions by Supreme Court:**

The Supreme Court then proceeded to analyse the various judgments issued by Authority for Advance Ruling (for brevity ‘AAR’), Tribunals and High Courts. The discussion can be summarised as under:

S No	Authority	Matter	Analysis
1	AAR	Dassault Systems KK <sup>11</sup>  (India – Japan DTAA)  <b><u>(Approved by SC)</u></b>	<ul style="list-style-type: none"> <li>• Dassault Systems UK, a company incorporated in Japan, which marketed licensed computer software products, through a distribution channel comprising value added resellers (VAR), who were independent third party resellers in the business of selling software to end-users.</li> <li>• The question before AAR was that whether the amounts arising from sale of software products to independent third party resellers will be taxable as business profits under Article 7 and will not constitute royalties and fee for technical services as defined in Article 12?</li> <li>• The AAR before proceeding to answer the above question made reference to classic treatise of Copinger and Skon James on Copyright.</li> <li>• The AAR has extracted a passage from the above classic treatise wherein it was stated as <b><i>‘It is important to recognize that ownership of copyright in a work is different from the ownership of the physical material in which the copyright work may happen to be embodied. Just as the owner of the physical material on which a copyright work is first recorded is not necessarily the first owner of the copyright, so the transfer of title to the original physical material does not by itself operate to transfer the title to the copyright. Thus, to take an obvious example, the purchaser of a book or video recording becomes the owner of the physical article but he does not thereby become the owner of any part of the copyright in the works reproduced in it. The copyright in the literary work remains with the copyright owner, who enjoys and is entitled to enforce all the exclusive rights of copying, publication, adaptation, sale, rental and so on conferred on him by copyright law. The purchaser does not acquire by his purchase any right, either by way of assignment or license, to exercise any of those exclusive rights’.</i></b></li> <li>• Another important passage which was referred by AAR, wherein it was stated that <b><i>‘A mere licence from the copyright owner confers no proprietary interest on the licensee enabling him, for example, to bring proceedings in his own name, unless coupled with the grant of some other interest, for example, the right to take property away. Statute apart, even an exclusive licence, which is merely</i></b></li> </ul>

<sup>11</sup> [2010] 322 ITR 125 (AAR)

			<p><i>the leave to do a thing coupled with a promise not to do, or give anyone else permission to do that thing, gives the licensee no right to sue in his own name for infringement nor any other proprietary interest. In copyright law this general rule is altered by statute in the case of exclusive licences which comply with prescribed formalities. The 1988 Act confers on such a licensee a procedural status which enables him to bring proceedings but otherwise the rule is unchanged: an exclusive licensee has no proprietary interest in the copyright’.</i></p> <ul style="list-style-type: none"> <li>• The AAR after setting out the terms in EULA has stated that end-user is not given the authority to do any of the acts contemplated in Section 14(a) not to speak of exclusive right. Further, the entire tenor of the agreement and various stipulations contained therein make it clear that no rights in derogation of the Dassault System’s exclusive right in relation to the copyright have been conferred to end-user or VAR. The core of the transaction in the words of AAR is that to authorise the end-user to have access to and make use of licensed software products over which the Dassault System’s have exclusive copyright, without giving any scope for dealing with them any further.</li> <li>• The AAR further stated that passing on a right to use and facilitating the use of a product for which the owner has a copyright is not the same thing as transferring or assigning rights in relation to copyrights. <b><u>The enjoyment of some or all the rights which the copyright owner has, is necessary to trigger the royalty definition.</u></b> Accordingly, an agreement with a non-exclusive and non-transferable license enabling the use of a copyrighted product cannot be construed as an authority to enjoy any or all of the enumerated rights ingrained in copyright.</li> <li>• The AAR made an important observation with respect to the phrase ‘including the granting of license’ found in Explanation 2(v) to Section 9(1)(vi). The AAR stated that does not mean that even a non-exclusive license permitting user for in-house purpose would be covered by that expression. Any and every license is not what is contemplated and it should take colour from the preceding expression ‘transfer of rights in respect of copyright’.</li> <li>• The AAR then concluded stating that <b><u>the exclusive right to prevent copying or reproduction of work is the most fundamental and historically oldest right of a copyright owner. Since the end-user never had any rights referred in Section 14(a), the question of subject payment as royalty does not arise.</u></b></li> </ul>
2	AAR	<p>Geoquest Systems B V Gevers Deynootweg<sup>12</sup></p> <p>(India – Netherlands DTAA)</p> <p><b><u>(Approved by SC)</u></b></p>	<ul style="list-style-type: none"> <li>• The Applicant sold certain software packages to the Oil and Natural Gas Corporation in India. The applicant has approached AAR to determine whether the said amounts paid by Oil and Natural Gas Corporation would constitute royalty.</li> <li>• The AAR following the decision in their earlier matter of Dassault Systems KK has held that the amounts paid by the buyer are not in the nature of royalties.</li> </ul>
3	AAR	<p>Citrix Systems Asia Pacific Ptyl. Ltd<sup>13</sup></p> <p>(India – Australia DTAA)</p> <p><b><u>(Rejected by SC)</u></b></p>	<ul style="list-style-type: none"> <li>• The AAR once again was confronted with a similar question as in the case of two above. The Australian company had entered into a distribution agreement with an independent Indian company engaged in business of distribution of computer software and hardware.</li> <li>• The AAR after setting out the various provisions of ITA and Indo-Australian DTAA has arrived at a diametrically opposite conclusions to that of Dassault (supra) and Geoquest (supra). The AAR has stated that when a software is created by a person who acquires a copyright for it, he becomes the owner of that copyright. He can</li> </ul>

<sup>12</sup> [2010] 327 ITR 1 (AAR)

<sup>13</sup> [2012] 343 ITR 1 (AAR)

			<p>transfer or license that right either by himself or through an agent. When he sells or licenses for software for use, he is also selling or licensing the right to use the copyright embedded therein. The AAR stated that whenever a software is assigned or licensed for use, there is involved an assignment of the right to use the embedded copyright in the software or a license to use the embedded copyright, the intellectual property right in the software. Therefore, it concluded that it is not possible to divorce the software from the intellectual property right of the creator of the software embedded therein and accordingly the payment would be called as royalty.</p> <ul style="list-style-type: none"> <li>• The AAR has distinguished the decision in the matter of Dassault (supra) by stating that the facts involved in said matter was that the end-user has no rights in the license except using the same. The AAR however have not stated that the fact pattern in the subject matter are different.</li> </ul> <p><b>Observations by Supreme Court:</b></p> <ul style="list-style-type: none"> <li>• The Supreme Court rejected the above observations of AAR. The Supreme Court stated that what an end-user would obtain is a copy of license and cannot be stated that, what is also licensed is the right to use the copyright embedded therein. The Court stated that EULA would never involve transfer of rights as envisaged under Section 30 or Section 14 of Copyright Act.</li> </ul>
4	HC [KA]	<p>Samsung Electronics Co. Limited<sup>14</sup></p> <p>(India – USA) (India – France) (India – Sweden)</p> <p><b><u>(Rejected by SC)</u></b></p>	<ul style="list-style-type: none"> <li>• The Karnataka High Court has also stated that what was sold/licensed by way of computer software, included the grant of a right or interest in copyright, and thus gave rise to the payment of royalty. The Court stated that the right to make a copy of the software and use it for internal business by making the copy of the same and storing the same in the hard disk of the designated computer and taking back up would itself amount to copyright work under Section 14 of Copyright.</li> <li>• The Court therefore hold that amount paid towards supply of shrink-wrapped software or off-the-shelf software is not the price of CD alone nor software alone nor the price of license granted. The court stated that this is a combination of all and in substance, unless license is granted permitting the end user to copy, and download the software, the dumb CD containing software would not in any way be helpful to the end user as software would become operative, only if it is downloaded to the hardware of the designated computer as per the terms and conditions of the agreement and that makes the difference between the computer software and copyright, in respect of books or pre-recorded music [CD], as book and pre-recorded music CD can be used once they are purchased, but so far as software stored in dumb CD is concerned, the transfer of dumb CD by itself would not confer any, right, upon the end user and the purpose of the CD is only to enable the end user to take a copy of the software and to store it in the hard disk of the designated computer if licence is granted in that behalf and in the absence of licence, the same would amount to infringement of copyright, which is exclusively owned by non-resident suppliers, who would continue to be the proprietor of copyright.</li> <li>• Therefore the Court has held that there is no similarity between the transaction of purchase of book or CD containing software and in view the same, the legislature in its wisdom, has treated the literary work like books and other articles separately from ‘computer software’ within the meaning of copyright as referred under Section 14 of Copyright Act.</li> </ul>

<sup>14</sup> [2012] 345 ITR 494

			<p><b>Observations by Supreme Court:</b></p> <ul style="list-style-type: none"> <li>The Supreme Court has stated that the Karnataka High Court has erred in the same way as the AAR erred in Citrix Systems (supra). The Supreme Court stated that the failure to make a distinction between computer software that was sold/licensed on a CD/other physical medium and the parting of the copyright in respect of any of the rights or interest in any of the rights mentioned in Section 14(a) and Section 14(b) of the Copyright Act.</li> </ul>
5	HC [KA]	<p>Synopsis International Old Limited<sup>15</sup></p> <p>(India – Ireland DTAA)</p> <p><b><u>(Rejected by SC)</u></b></p>	<ul style="list-style-type: none"> <li>In this matter, the Karnataka High Court placing extensive importance on the phrase ‘in respect of’ appearing in Explanation 2(v) to Section 9(1)(vi) has held that without transferring a right in the copyright it is possible to receive consideration for the use of intellectual property for which the owner possess copyright. Ultimately, the consideration paid for the usefulness of the material object in respect of which there exists a copyright. Therefore, the court held that the intention was not to exclude the consideration paid for the use of such material object which is popularly known as copyrighted article. The court held that even in respect of a copyrighted article the same is transferred, no doubt the right in the copyright is not transferred, but a right <b><u>in respect of a copyright contained in the article is transferred and accordingly the said payment would fall under the ambit of royalty.</u></b></li> <li>The Court also made an observation that the meaning of ‘copyright’ as laid down in Copyright cannot be imported into the ITA. The Court held that the Explanation 2 to Section 9(1)(vi) made it clear that royalty would mean consideration for transfer of all or any rights including the granting of license and therefore, the word exclusive right used in Section 14 do not fit in the meaning of royalty as per Explanation 2. The Court’s reasoning is that since the ITA lays down a specific meaning for ‘royalty’, the consideration has to be decided in terms of such meaning and not under the meaning as per Copyright Act. Accordingly, the Court held that payments made for acquisition of partial rights in the copyright without the transfer fully alienating the copyrights will represent royalty where the consideration is for granting of rights to use the programme in the manner that would, without such license, constitute an infringement of copyright. The Court further held that the definition of ‘royalty’ as per DTAA would mean payment of any kind received as a consideration for the use or the right to use any copyright and does not mean that there should be an exclusive transfer to treat the consideration as ‘royalty’.</li> </ul> <p><b>Observations by Supreme Court:</b></p> <ul style="list-style-type: none"> <li>The Supreme Court referring to State of Madras v. Swastik Tobacco Factory<sup>16</sup> debunked the rationale of High Court with respect to the interpretation of the phrase ‘in respect of’. The Supreme Court said that as far as taxation statutes are concerned, the phrase ‘in respect of’ has to be understood as ‘on’ or ‘attributable to’ and the assigning any other meaning as done by Karnataka High Court is not called for.</li> <li><b><u>The Supreme Court stated that there is no other recognition of copyright outside Section 16 of Copyright Act. Hence, the reasoning of Karnataka High Court that the meaning of copyright as per Explanation 2 to Section 9(1)(vi) is applicable for determination of whether an amount is royalty was rejected. The Supreme Court held that the phrase ‘copyright’ has to be understood only in terms of Section 16 of Copyright and Explanation 2 to Section 9(1)(vi) may be a sub-set to that but cannot go beyond the former.</u></b></li> </ul>

<sup>15</sup> 2013 (2) TMI 448

<sup>16</sup> (1966) 3 SCR 79

			<ul style="list-style-type: none"> <li>The Supreme Court also held that when a copyrighted article is sold, the end-user gets the right to use the intellectual property rights embodied in the copyright which would therefore amount to transfer of exclusive right of the copyright owner in the work, is also wholly incorrect.</li> </ul>
6	HC [Delhi]	Ericsson A.B <sup>17</sup>  (India –Sweden DTAA)  <b><u>(Approved by SC)</u></b>	<ul style="list-style-type: none"> <li>The facts in this matter were, the assessee was a company incorporated in Sweden which entered into agreement with Indian cellular operators, pursuant to which the assessee supplied various equipments (hardware) embedded with software.</li> <li>The revenue demanded that the Indian cellular operators would have deducted tax on payments made because the equipment also had a component of software and accordingly the payments made include payments in nature of ‘royalty’.</li> <li>The High Court rejected the stand taken by Revenue by holding that what the Indian cellular operators has received is an integrated unit, GSM, which is used for provision of services. The software embedded on the hardware unit is required to provide the services and the software cannot be used independently by the service provider. Hence, the consideration paid for the GSM cannot be split and tax can be levied on the software part. Further, the High Court held that even assuming that the consideration can be split, there is no payment in the nature of royalty, since the assessee has not transferred any right in terms of Section 14 to trigger the provisions of Section 9(1)(vi) of ITA.</li> <li>The High Court also held that once the software is put on a hardware/media, the same would constitute ‘goods’ as held by Supreme Court in the matter of Tata Consultancy Services (supra).</li> </ul>
7	HC [Delhi]	Nokia Networks OY <sup>18</sup>  (India – Finland DTAA)  <b><u>(Approved by SC)</u></b>	<ul style="list-style-type: none"> <li>In this matter, the High Court held that the right to use simpliciter of a software programme itself does not constitute any transfer of copyright. The High Court also held that the retrospective amendments made vide Explanation 4 to Section 9(1)(vi) could not override what is stated in treaties, following the decision of Siemens Aktiengesellschaft<sup>19</sup>. The High Court following its earlier decision in Ericsson, wherein it was held that a copyrighted article does not fall within the purview of Article 12 of DTAA, applied the same in this matter and held that payments would not fall under the expression of ‘royalty’.</li> </ul>
8	HC [Delhi]	Infrasoft Limited <sup>20</sup>  (India –USA DTAA)  <b><u>(Approved by SC)</u></b>	<ul style="list-style-type: none"> <li>In this decision, the High Court was seized with the facts that whether amounts paid by civil engineers in India to an assessee which was primarily engaged in business of developing and manufacturing civil engineering software, would fall in the ambit of royalty?</li> <li>The Delhi High Court placed reliance on the decision of Special Bench of Tribunal in the matter of Motorola Inc<sup>21</sup>, wherein it was held that since there was no transfer of rights as mentioned in Section 14 of Copyright Act, the payments made would not fall under the definition of royalty either under ITA or DTAA. The Special Bench held that since in the facts before them, what was granted was a non-exclusive restricted license, the same cannot be said to be the right mentioned in Section 14 of Copyright Act and therefore what the payers got was only a copyrighted article and not copyright itself.</li> </ul>

<sup>17</sup> [2012] 343 ITR 470

<sup>18</sup> [2013] 358 ITR 259

<sup>19</sup> 310 ITR 320 (Bom)

<sup>20</sup> [2014] 264 CTR 329

<sup>21</sup> [2005] 147 Taxman 39 (Delhi)

			<ul style="list-style-type: none"> <li>• The Delhi High Court rejected the reliance placed by Revenue on the AAR's determination in the matter of Citrix Systems (supra) by stating that one cannot have the copyright right without the copyrighted article but at the same time just because one has the copyrighted article, it does not follow that one has also the copyright.</li> <li>• The Delhi High Court then referring to its earlier judgments in Ericsson AB (supra) and Nokia Networks OY (supra) and AAR's determination in Dassault (supra) and Geoquest (supra) concluded that in order to qualify a payment as royalty, a distinction has to be made between the acquisition of 'copyright right' and 'copyrighted article'. <b><u>Copyright is distinct from the material object, copyrighted.</u></b> The court held that right to use a copyrighted article or product with the owner retaining his copyright, is not the same thing as transferring or assigning rights in relation to copyright. <b><u>The enjoyment of some or all the rights which the copyright owner has, is necessary to invoke the definition of 'royalty'.</u></b></li> <li>• The Delhi High Court has not agreed with the decision of Karnataka High Court in the matter of Samsung Electrical Co. Limited (supra) by stating that the right to make a back-up copy purely as temporary protection against loss, destruction or damages does not amount to acquiring a copyright in the software.</li> </ul>
9	HC [Delhi]	<p>ZTE Corporation<sup>22</sup>          (India – China DTAA)  <u>(Approved by SC)</u></p>	<ul style="list-style-type: none"> <li>• The Delhi High Court held that the assessee before them is the copyright proprietor, who has made available, through one time license fee, the software to its customers, this software without the hardware, which was sold, is useless. Conversely, the hardware sold by the assessee to its customers is also valueless and cannot be used without such software. The Court held that this analysis is to show that what was conveyed to its customers by the assessee bears a close resemblance to goods. The question of conveying or parting with copyright in the software would mean that the copyright proprietor has to assign it, divesting itself of the title implying that it has divested itself all the rights under Section 14. This would mean an outright sale of the copyright or assignment, under Section 18 of Act and Section 16 of Copyright Act enacts that there cannot be any other kind of right termed as 'copyright'.</li> </ul>
<p><b>Conclusions by Supreme Court</b></p>			<p>The Supreme Court has arrived at the below conclusions after reading the above judgments as under:</p> <ul style="list-style-type: none"> <li>• Copyright is an exclusive right, which is negative in nature, being a right to restrict others from doing certain acts.</li> <li>• Copyright is an intangible, incorporeal right, in the nature of a privilege, which is quite independent of any material substance. Ownership of copyright in a work is different from the ownership of the physical material in which the copyrighted work may happen to be embodied. An obvious example is the purchaser of a book or a CD/DVD, who becomes the owner of the physical article, but does not become the owner of the copyright inherent in the work, such copyright remaining exclusively with the owner.</li> <li>• Parting with copyright entails parting with the right to do any of the acts mentioned in section 14 of the Copyright Act. The transfer of the material substance does not, of itself, serve to transfer the copyright therein. The transfer of the ownership of the physical substance, in which copyright subsists, gives the</li> </ul>

<sup>22</sup> [2017] 392 ITR 80

purchaser the right to do with it whatever he pleases, except the right to reproduce the same and issue it to the public, unless such copies are already in circulation, and the other acts mentioned in section 14 of the Copyright Act.

- A licence from a copyright owner, conferring no proprietary interest on the licensee, does not entail parting with any copyright, and is different from a licence issued under section 30 of Copyright Act, which is a licence which grants the licensee an interest in the rights mentioned in section 14(a) and 14(b) of the Copyright Act. Where the core of a transaction is to authorize the end-user to have access to and make use of the 'licensed' computer software product over which the licensee has no exclusive rights, no copyright is parted with and consequently, no infringement takes place, as is recognized by section 52(1)(aa) of Copyright Act. It makes no difference whether the end-user is enabled to use computer software that is customised to its specifications or otherwise.
- A non-exclusive, non-transferable licence, merely enabling the use of a copyrighted product, is in the nature of restrictive conditions which are ancillary to such use, and cannot be construed as a licence to enjoy all or any of the enumerated rights mentioned in section 14 of the Copyright Act, or create any interest in any such rights so as to attract section 30 of the Copyright Act.
- The right to reproduce and the right to use computer software are distinct and separate rights, as has been recognized in State Bank of India (supra), the former amounting to parting with copyright and the latter, in the context of non-exclusive EULAs, not being so.

#### **Doctrine of First Sale/Principle of Exhaustion:**

The Supreme Court then proceeded to analyse the concept of doctrine of first sale/principle of exhaustion. The Revenue's contention was that on the facts of the cases involved in appeal, the doctrine of first sale/principle of exhaustion would have no application inasmuch as the doctrine is not statutorily recognised in Section 14(1)(b)(ii) of Copyright Act. This being so, the revenue contended that since the distributors of copyrighted software license or sell such computer software to end-users, there would be parting of a right or interest in copyright inasmuch as such license or sale would then hit by Section 14(b)(ii).

The Supreme Court rejected the above contention by referring to Copinger and Skone James on Copyright, wherein it was stated that an important aspect of the distribution right is that it is exhausted in relation to a particular article by the first sale of that article in community by the right holder or with his consent. The Court then proceeded to refer to the judgment of Delhi High Court in the matter of Warner Bros. Entertainment v. Santosh V G<sup>23</sup>, wherein the concept of doctrine of first sale/principle of exhaustion was discussed. The Delhi Court vide Para 58 stated that exhaustion right is linked to the distribution right and the right to distribute objects (making them available to the public) means that such objects (or the medium on which work is fixed) are released by or with the consent of the owner as a result of the transfer of ownership. The court stated that in this way, the owner is in control of the distribution of copies since he decides the time and form in which copies are released to public. Content-wise the distribution right are to be understood as an opportunity to provide the public with copies of work and put them into a circulation, as well as to control the way

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<sup>23</sup> [2009] SCC OnLine Del 835

the copies are used. The exhaustion of rights principle thus limits the distribution right, by excluding control over the use of copies after they have been put into circulation for the first time.

The Supreme Court after referring to the judgment of European Court of Justice in the matter of *UsedSoft GmbH v. Oracle International Corp*<sup>24</sup> and judgment of United States Court of Appeal for the Ninth Circuit in matter of *Verner v. Autodesk Inc*<sup>25</sup> has concluded that the doctrine of first sale/principle of exhaustion is dependent, in the first place, upon legislation which either recognises or refuses to recognise the doctrine (thereby continuing to vest distribution right in the copyright owner, even beyond the first sale of copyrighted article). The Supreme Court stated that prior to the amendment in 2012 to Section 14(d)(ii), which deals with cinematograph film, the legislative intent is clear to refuse to recognise the doctrine of first sale. In other words, prior to amendment, the copyright owner would continue to control the distribution rights even beyond the first sale of copyrighted work. However, post 2012, the amendment dropping the phrase 'regardless of whether such copy had been sold or given on hire on earlier occasion', the legislative intent is clear to recognise the doctrine of first sale. In other words, post amendment, the copyright owner does not continue to have the distribution right post the first sale.

In similar way, the Supreme Court stated that Section 14(b)(ii) has also been amended in 2000, to delete the phrase 'regardless of whether such copy had been sold or given on hire on earlier occasion', thereby making it clear that the tilt has been in favour of the purchaser. The Court further stated that language of Section 14(b)(ii) of Copyright Act makes it clear that is the exclusive right of the owner to sell or to give on commercial rental or offer for sale for commercial rental 'any copy of the computer programme'. The Court stated that a distributor who purchases computer software in material form and resells it to an end-user cannot be said to be within the scope of above said provision for the reason that 'any copy of computer programme' would mean that the same would apply to making the copies of the computer programme and then selling them, i.e., reproduction of the same for sale or commercial rental.

The Supreme Court stated that the object of Section 14(b)(ii) is to prohibit reproduction of the said computer programme and consequent transfer of the reproduced computer programme to subsequent acquirers/end-users. Hence, the distributor who is engaged in resale of the computer programme does not get in the way of Section 14(b)(ii). The Court concluded that once it is understood that the object of Section 14(b)(ii) is not to prohibit the sale of computer software that is 'licensed' to be sold by a distributor, but that it is to prevent copies of computer software once sold being reproduced and then transferred by way of sale or otherwise, it becomes clear that any sale by the author of a computer software to a distributor for onward sale to an end-user, cannot possibly be hit by the said provision. Accordingly, the Court concluded that the contention of Revenue that the distribution of copyrighted computer software would constitute grant of an interest in copyright under Section 14(b)(ii) cannot be accepted.

Accordingly, the Supreme Court concluded that amounts paid by resident Indian end-users/distributors to non-resident computer software manufacturers/suppliers, as consideration for resale or use of the computer software through EULAs/distribution agreement, is not the payment of royalty for the use of copyright in the computer software and the same does not give rise to any income taxable in India. The Court held that the above conclusions would apply to all the four categories.

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<sup>24</sup> Case C – 128/211

<sup>25</sup> 621 F.3D 1102 (9<sup>th</sup> Cir.2010)